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**Political Economy and Public Law,**  
**No. 13.**

A Discussion of the Interrogatories of the Monetary  
Commission of the Indianapolis Convention.

JOSEPH FRENCH JOHNSON, B. A.

With Supplementary Suggestions by

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NOT A PERIODICAL

## NOTE.

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THIS pamphlet contains no attempt at the presentation of a well-rounded scheme for monetary reform. It consists of a series of letters not primarily designed for publication. They were written in response to a circular of interrogatories issued by the Monetary Commission appointed by resolution of a convention composed of delegates from Boards of Trade, Chambers of Commerce, and similar organizations, which met in Indianapolis in January, 1897. The Commission was requested by the Convention "to make a thorough investigation of the monetary affairs and needs of the country in all relations and aspects, and to make proper suggestions as to the evils found to exist and the remedies therefor." In order to get the opinions of outsiders the Commission invited replies to a list of questions which they distributed. These questions are reprinted on pages 3 and 4 of this pamphlet. As they imply the possible adoption of one or another of several radically different reforms, a categorical discussion of the points raised leads to a consideration of the merits of various measures, rather than to a succinct and consistent statement of any one plan. The plan finally adopted by the Commission and embodied in a bill which has been recently introduced in the House of Representatives, provides for the gradual retirement of the United States Notes, for the issue of unguaranteed bank notes based upon bank assets, for the redemption on demand of silver dollars, and for the issue of silver certificates in small denominations only. The wisdom of such recommendations is considered at some length in the following discussion.

JOSEPH FRENCH JOHNSON.

*University of Pennsylvania, January 27, 1898.*

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# THE MONETARY COMMISSION.

## INTERROGATORIES.

### METALLIC CURRENCY.

1. Should or should not the silver dollar and silver certificates be redeemed on demand in gold? If redeemed, what reserves should be provided, and how?
2. What in your judgment would be the probable amount of silver dollars and silver certificates presented, if direct redemption were enacted?
3. To insure the permanent inviolability of the gold standard, what legislative measures would you recommend?
4. For the purpose of facilitating the use of existing silver currency, what do you recommend as the smallest denomination of United States notes and bank notes which should be put into circulation?

### DEMAND OBLIGATIONS.

1. Do you consider that there are any dangers arising from allowing the United States notes to remain as a permanent part of our circulation?
2. On what grounds, if any, would you favor the gradual but entire withdrawal of the Treasury notes of 1890 and of the United States notes?
3. If it shall be decided to retire the United States notes, how can it be done without adding to our bonded debt?
4. How, in that case, can provision be made for maintaining an adequate amount of currency available for purposes of business?
5. If it be thought inexpedient to fund the United States notes, how can they be redeemed with an assurance that bank currency will take their place.
6. Meanwhile, what security or gold reserves would you recommend?
7. In case provision should be made for the retirement of United States notes, how could their presentation for redemption be best secured?
8. Should Government issues be withdrawn only as bank notes are put out? That is, if an elastic system of bank issues should be adopted, would it be desirable to define and maintain any given quantity of circulation?
9. Would the banks, in fact, furnish the currency which the country needs, if the government notes were withdrawn?

### BANKING.

1. Is it possible to rely upon national bonds as security for bank note issues?

2. Can any safe and practicable plan be devised for using any other securities as a basis for bank note issues?

3. If bonds should be used exclusively as a basis for issues, would it be possible thereby to secure an elastic note circulation?

4. If bank note issues be based exclusively on assets of the bank, is the nature and extent of the security such as effectually to protect the note holder? What limit should be set to such note issues?

5. Since bank assets (including stock-holder's liabilities, etc.) must be the means of ultimate redemption of such issues, what funds would you deem necessary to be held as a cash reserve for the redemption of the notes; and in what form; and in whose hands?

6. In case of notes based on bank assets, what means can you suggest to obtain and preserve a high character of discounts?

7. Can any watchfulness of other banks connected by locality or business connections be brought to bear on a bank to prevent bad banking? Can such a scheme be devised as in cities where Clearing-House Associations detect and punish weakness, by which country banks can be guarded?

8. What plan of examination and inspection would you recommend?

9. What methods would you suggest by which uniformity of note issues based on assets could be secured throughout the country? If by redemption, state where and how?

10. What, if anything, beyond provision for immediate redemption is needed for securing the elasticity of note issues in periods of normal business?

11. In times of panic or sudden stringency, how would you provide for additional issues by the banks to enable them to continue discounts and prevent commercial distress?

12. Of what should the bank reserve consist?

13. Should any National bank be permitted to pay interest on the current deposits of other banks?

14. Should deposits of country banks in reserve cities be authorized to be counted as a part of the required reserve?

15. What should be the minimum limit of capital for National banks?

16. Should the existing ten per cent. tax on State bank notes be repealed?

17. Should any National bank be permitted to establish branches under its single management? If so, under what limitations, if any?

18. Should branch banks be obliged to redeem the notes of the parent bank and of other branches?

19. Should branch banks be required to maintain any specified proportion of reserves to liabilities, independent of regulations for the general accounts of the parent bank.

TO THE HONORABLE GEORGE F. EDMUNDS, CHAIRMAN  
OF THE MONETARY COMMISSION OF THE INDIAN-  
APOLIS CONVENTION :

Before taking up in order the questions under "Metallic Currency" and "Demand Obligations," which will lead me into a discussion of various compromise measures, I wish to state emphatically my opinion that in order to maintain the gold standard inviolate, the gold base of our monetary system must be broadened. The proportion of credit-money now in existence is too large. It amounts to \$1,000,000,000, or over 60 per cent. of the total money supply. It should be reduced at least two-thirds. The United States notes and the Sherman notes of 1890, both direct demand obligations, should be retired and gold should take their place. Their retirement should be gradual and should be effected by the issue of bonds, or when possible by the use of surplus revenues. The National bank notes, as now issued, are a useless and dangerous element of the currency, for the continued existence of which there is absolutely no reason. They should be retired and either gold substituted in their place or bank notes whose volume will expand and contract with the varying needs of business. These changes having been effected, the existing silver currency (coined dollars, or their representatives, the certificates) may be continued in use without endangering the system and without embarrassing the government, although in an ideal monetary system based upon gold, no more silver should be employed than the people desire to use in the shape of coin. At the present time that amount is about \$60,000,000. The country, however, can easily absorb about \$400,000,000 in credit-money, and its use should be permitted, for it economizes the use of the standard metal. While silver, on account of its cost, is *per se* less desirable than paper as the material

for credit-money, nevertheless under present conditions our silver currency, for the reason that it is not a direct demand obligation of the government, is less objectionable than any of the existing varieties of paper money. Our silver credit-money, therefore, I would leave unchanged.

I am well aware, however, that some of the radical changes I have described may be regarded as politically impossible. It may be wise to compromise and not to endeavor at the present time to force through Congress all the measures necessary to establish our system firmly upon the gold basis. I have assumed, therefore, in my replies to the interrogatories, that your Commission may desire to consider the merits of temporary expedients as well as of ideal measures. I discuss the questions in the order presented.

#### METALLIC CURRENCY.

1. There is no reason why the silver currency should be redeemed on demand in gold. Its parity with gold will be maintained without difficulty if its full legal tender quality is preserved. The silver certificate should be the full representative of the silver dollar, whereas at present it is not legal money in redeeming bank circulation. It would be dangerous to increase the present amount of our silver currency.

2. If silver dollars (or silver certificates) were made redeemable in gold on demand, none would be presented for redemption except when gold was wanted for export. The fact of their redeemability would not increase the total demand on the United States Treasury for gold. They would never be presented for redemption merely because the holders wanted to get rid of them, but always because the holders wanted gold either for export or for use in the arts. For these two purposes silver and the United States notes would be used indifferently, whereas the notes now serve these purposes alone.

3. To insure the permanent inviolability of the gold standard, it would be necessary: First, to retire and cancel

at least \$600,000,000 of our present stock of credit-money, either by funding it or by the use of surplus revenues ; and, second, to establish an elastic system of bank note issues, which by their automatic expansion and contraction would reduce to a minimum the need for gold imports and exports. The United States notes, the Sherman notes and the existing National bank notes should be retired, and gold substituted. If the greenbacks for political reasons cannot be retired, it would be well to continue the conversion of the Sherman notes into silver certificates, but the seigniorage (amounting to some \$50,000,000) should not be coined. A further enlargement of our stock of credit-money by the coinage of this seigniorage will amount to an arbitrary inflation of the money supply. This inflation will tend to disturb the money market and to induce an exportation of gold that may embarrass the National Treasury.

4. I know of no good reason for desiring to facilitate the general or popular use of silver currency, whether coined dollars or certificates ; but there are reasons for facilitating the use of United States notes if they cannot be retired. They are the instruments used for the withdrawal of gold from the United States Treasury. They exist at the present time in bills of large denominations, and therefore, are not in wide use among the people, but are stored largely in the vaults of banks, and consequently are easily accessible whenever a demand for gold for export arises.

In my opinion the United States Treasury should not be called upon to furnish gold to exporters. When gold is wanted for export it is wanted as a commodity, and those who want it should be forced, so far as possible, to go into the markets after it as they would go after any other commodity. It is not necessary, in order to maintain the gold standard, for the United States government to facilitate the process by which gold is withdrawn from its reserves. The Bank of England guards its gold by raising its discount rate. The gold supply of France is protected both by its

seigniorage charge and by the discretionary policy of the Bank of France, which declines to redeem its notes in gold if it wishes to prevent the export of that metal. And in Germany the Imperial Bank hinders the exportation of gold, when so disposed, by asking a premium for it. Notwithstanding these restrictions upon the exportation of gold, the gold standard is maintained beyond question in these three countries.

Of all the large nations upon the gold standard the United States is the only one which freely offers its gold for export and voluntarily facilitates the process whereby it is drawn from the government reserve. I believe it will be safe to enter upon a policy of restriction, the ultimate purpose of which will be to compel exporters to seek gold as a commodity in the markets of the country. I would recommend, therefore, that the United States notes be issued in no denominations above \$5. The total amount of currency outstanding in \$1's, \$2's and \$5's is about \$375,000,000, of which amount about \$60,000,000 is silver coin. Thus the country uses of paper currency about \$300,000,000 in denominations under \$10. All these small bills are needed in business and are not sought after for bank reserves. The total amount is now divided as follows :

|                      |  |
|----------------------|--|
| Silver certificates, | \$132,000,000                                |
| U. S. notes . . . .  | 60,000,000 (only \$5,000,000 in 1's and 2's) |
| Sherman notes . .    | 60,000,000 (\$20,000,000 in 1's and 2's)     |

Now, if the silver certificates and bank notes are restricted to denominations of \$10 and upwards, while United States notes are issued only in 1's, 2's and 5's, the latter would necessarily at all times be pretty well scattered throughout the country and would be practically unavailable as instruments for the withdrawal of gold from the Treasury.

Objection may be made that there would be danger that the greenbacks would be collected whenever a demand for gold arose and that a dearth of small bills would thus be produced. In my opinion this objection is not a weighty

one. The banks throughout the country, which alone could be the agents for such collection of United States notes, are never desirous to facilitate the exportation of gold, and only a large premium upon greenbacks would tempt them to subject their customers to inconvenience by the withdrawal from circulation of any large quantity of small notes. It is quite possible that a small portion of the greenbacks would be presented for redemption at times when gold was in great demand. The vacuum thus produced in the supply of small bills might result in an increased use of silver dollars, which could be obtained by the redemption of certificates, but I do not believe that serious inconvenience to the public would result.

If the greenbacks are out of the way, having been either redeemed or made difficult to procure, the silver currency, large as its present volume is, cannot possibly threaten the maintenance of the gold standard. In some countries of Europe, France especially, the presence of silver in the currency is a cause of disquietude; but in this country the government notes, not silver, are the menacing element of the currency. If, therefore, these notes are not to be retired, it would be well to provide for their free use among the people in small transactions. It would follow, of course, that our banking reserves would consist mainly of silver and gold, but to this there could be no objection. The bank notes should be restricted to \$10 and upwards.

#### DEMAND OBLIGATIONS.

1. The United States notes are an objectionable element of the circulation and should be redeemed if possible. The danger arising from their presence in the circulation will be greatly lessened, however, if an elastic bank note issue is provided. It would also be lessened if they were issued only in small denominations and did not serve as a basis for certificates, but were distributed in the hands of the people throughout the country. In my opinion if the greenback cannot be retired, the wisest way to make it comparatively

harmless lies in the direction of banking reform, *i.e.*, in the creation of an elastic bank note issue. Our credit-money, including silver, greenbacks, Sherman notes and bank notes, constitutes over 60 per cent. of the total money-supply. This is a large percentage, but in Belgium the credit-money constitutes over 70 per cent. of the total, and yet the gold standard is maintained there without embarrassment, the bank note issue being elastic. In England credit-money constitutes about 27 per cent. of the total; in Germany 35 per cent., and in France 40 per cent. It is interesting to note that while England employs relatively less credit-money than any other country in Europe, it is most disturbed by gold movements. France, although its proportion of credit-money is much larger, is little embarrassed by gold movements. England's currency is absolutely inelastic, while that of France is elastic, the bank notes being capable of practically indefinite expansion.

While discussing United States notes, it may be well to say that I heartily approve, as an expedient, the suggested creation of a separate department, in the Treasury, to be known as the Issue and Redemption Department, in which are to be deposited \$125,000,000 of gold and the cash proceeds from \$200,000,000 2½ per cent. bonds, no paper money to be disbursed except in exchange for gold. The creation of such a department would in time enable the Treasury to lock up a large portion of the United States notes now in circulation and so make it less easy for gold exporters to make drafts upon the Treasury gold reserve. However, whatever may be done with the United States notes, it is quite certain that our monetary system will not work with perfect smoothness so long as we have credit-money of any kind outstanding, unless a banking system possessing some elasticity is adopted. I shall discuss this point more at length under the subject of banking.

It may be worth while to mention the fact that as the business and population of the country grow, there will be increased need for money and that the gold base of our

system will surely be enlarged year by year if we do not repeat the blunders of the last twenty years and go on increasing the volume of our silver and paper credit-money. As the gold in our currency increases, any possible danger arising from the presence of silver will steadily decrease.

2. As I have said, to make the gold standard secure, both the Sherman notes and the United States notes should be redeemed. If our silver currency were the only government credit-money in existence, its parity with gold could undoubtedly be maintained without direct redemption. There would be no necessity for a gold reserve at Washington. Gold, when needed for export, would be sought as a commodity. Indeed, it might command a slight premium at times, just as it has done during the last few years, and yet gold and silver money remain of equal purchasing power in the markets of the country. A premium of 1 per cent. upon gold would not mean that the gold standard had not been maintained, but simply that exporters wanted as a commodity a metal which at the time the people preferred to use as money.

However, I am inclined to doubt the advisability of endeavoring to secure the absolute retirement of the United States notes at the present time. While the Sherman notes can perhaps be withdrawn, any plan recommending the retirement of the greenbacks would at present be received adversely in Congress. It is probable, indeed, that any bill having as a vital or integral part of it the retirement of the United States notes, would fail utterly. On this account I deem it worth while to consider most carefully any plan which promises to render the greenback harmless while permitting its continued existence.

3. The United States notes can be retired by the judicious use of surplus revenue, always at the discretion of the Secretary of the Treasury in order that the money market may not be disturbed.

4. The Secretary of the Treasury should not retire the

United States notes except in seasons when the money supply exceeds the needs of business.

5. If a system of elastic bank notes has been established when the retirement of the greenbacks is begun, the vacuum will certainly be filled, either by gold or by banking currency, without any noticeable or injurious contraction of the money supply. The withdrawal of greenbacks should be gradual and entirely at the discretion of the Secretary. There is no reason for desiring that bank currency shall take their place. If bank notes rest solely upon assets of the banks and do not bear the government guaranty, the extent of their issue and the average amount of their circulation will depend entirely upon the degree of their acceptability among the people. One cannot be certain, therefore, that bank notes would take the place of the retired United States notes. But there is certainty that the vacuum would be filled either wholly by bank notes or by gold and bank notes together. As it is desirable to enlarge the gold base of our system, the substitution of gold for a portion of the United States notes is not something to be avoided.

6. It is assumed that the phrase "security or gold reserves" in this question refers to the gold reserve held in the United States Treasury. The law upon this subject should not be made definite or arbitrary. With an elastic bank note system in operation, the Treasury would always be strongly fortified if it held \$100,000,000. Owing, however, to the popular feeling that there is danger when the reserve falls below \$100,000,000 the Secretary should aim to keep it as near \$150,000,000 as possible in order that he may have on hand a balance available for use in emergencies.

7. On this point I have no suggestions to offer beyond what is involved in the foregoing.

8. If the greenbacks are to be retired, the Treasury policy should be to secure the substitution of gold in their place. Bank notes should be issued mainly for local uses, not for national. If the greenbacks are funded, the Secretary should aim to secure gold from abroad; but the process

should be gradual and the Secretary should have discretionary power in the premises.

9. The banks might furnish the currency that would take the place of the government notes, but it would be unwise to depend upon them. In other words, a scientific bank note issue should satisfy merely the fluctuating needs of the community, and should not be relied upon to fill any permanent vacuum in the country's need. The only kind of bank note that could safely be relied on to take the place of the government notes would be one issued by a bank of the United States, a National institution enjoying credit in all parts of the country. The notes of such an institution, like those of the Bank of France, the Bank of England and the Bank of Germany, even though not endorsed by the government and not legal tender, would have a wide circulation and constitute permanently a large though flexible part of the country's circulation. I have touched upon this point under Question 5. If we provide for a genuinely elastic banking currency, duly safeguarded, but not guaranteed by the National government, and also give note-issuing banks the privilege of maintaining branches, I have no doubt that bank notes will soon fill a place in our currency quite as large as that occupied now by United States notes. Nevertheless we cannot be certain upon this point. It would be unwise, therefore, to begin the redemption of greenbacks unless we are prepared to fill the vacuum with gold. However, if the process of redemption is gradual and always at the discretion of the Secretary of the Treasury, no vacuum need be created, the greenbacks being retired only in dull seasons when the currency is redundant.

#### BANKING.

The questions under "Banking" can best be answered after the presentation of what is believed to be a feasible plan for the creation of an elastic banking currency.

- a.* Divide the country into ten (more or less) bank note districts.

*b.* Permit banks whose capital and surplus equal not less than \$500,000 to issue notes to any extent not exceeding the amount of their capital and surplus.

*c.* Security of the notes :

1. District safety funds, each fund equal to 5 per cent. of the outstanding bank circulation issued in its district. These funds to be held at Washington and to be used for the redemption of the notes of failed banks ; but no fund to be liable for failures not occurring in its district.

2. Guaranty fund. Each note-issuing bank to deposit at Washington United States notes (or, with the consent of the Secretary of the Treasury, other legal tender money) equal to 10 per cent. of the amount of its circulation ; said 10 per cent. to be applied toward the redemption of the notes of the depositing bank in case of default.

3. The notes to constitute a first lien upon all the assets of the issuing bank.

4. Each bank shall hold in its own vaults a cash reserve in legal tender money equal to 15 per cent. of its notes outstanding in addition to the reserve which it is required to hold against deposit liabilities. The combined cash reserve in the vaults of a bank shall never be less than 25 per cent. of its total liabilities on account of deposits and notes, except that in emergencies, by consent of the Secretary of the Treasury, the cash reserves shall be available for redemption purposes and for loans and discounts.

*d.* To secure immediate redemption (and, therefore, elasticity) :

1. The notes of a bank shall be redeemable in legal tender money in two places : At its own counter, and at a central redemption agency in its district.

2. It shall be illegal for a note-issuing bank to pay out the notes of another bank.

3. The notes shall not be legal tender for any payments whatever.

4. The notes shall not be guaranteed by the government.

*e.* A note-issuing bank shall be permitted to estab-

lish branches at any point within its district, subject to approval of the Secretary of the Treasury.

*f.* Branch banks shall not pay out any bank notes except those of the parent bank.

*g.* A branch bank shall not be compelled to redeem the notes of the parent bank, nor to maintain any fixed reserve of cash.

*h.* The notes of a failed bank shall draw interest at 6 per cent. from the date of failure until such day as is named for their redemption by the Secretary of the Treasury.

*i.* A national bank not having the note-issuing privilege shall have the right to pay out the notes of any note-issuing bank.

*j.* A stockholder of a note-issuing bank shall be liable to the extent of twice the amount of his capital stock.

*k.* A tax upon banks sufficient to cover the expenses of governmental supervision, the printing of notes, etc.

QUESTIONS UNDER "BANKING."

1. National bonds cannot be relied on as security for bank-note issues. Public sentiment favors the reduction of the National debt. In all probability the amount of National bonds available for use as security for bank notes will steadily decrease, while the need for them, if they serve as the basis for bank notes, would increase with the growth of the country.

2. I have never seen a "safe and practicable plan" for using any kind of securities as a basis for bank-note issues.

3. With bonds as the exclusive basis for bank notes, banks will increase their circulation only when investment conditions make it profitable to do so. The withdrawal of circulation will likewise be dictated by investment conditions. The demand for a medium of exchange, to supply which is the proper function of bank notes, will not be considered in either case.

However, it is doubtful if any plan which entirely dispenses with deposited security, will at the present time be favorably received by the people or by Congress. For that reason, in the plan outlined above, it is proposed that bank notes be secured by a deposit of United States notes, or other legal tender money, equal to at least 15 per cent. of their amount. This requirement, while it would preserve a feature of our present banking system in which the people have confidence, would not prevent the banks from utilizing their credit in the shape of bank notes, whenever the need for a medium of exchange increased. On the other hand, the security would not be regarded as absolute, as is the security of the present National bank note, and the notes would be presented for redemption as soon as the exigencies calling them forth had been satisfied.

The banks should be required to deposit United States notes rather than bonds as security. Reliance upon bonds is objectionable, because of the speculative element that is necessarily introduced by the fluctuations in bond quotations. Banks should not be tempted to reduce their circulation merely because government bonds command an unusually high price. Furthermore, inasmuch as a bank's circulation will vary with the seasons, the amount of its deposit with the government will undergo changes at fixed periods (monthly or quarterly). To effect these changes United States notes will be more convenient than bonds.

(It is here assumed that the United States notes will continue to be issued in large denominations as at present. If, as was suggested above in the discussion of Question 4—"Metallic Currency"—the United States notes are issued exclusively in small denominations, then the 10 per cent. deposit in the guaranty fund should be in any form of legal tender money, including silver certificates.)

4. If the privilege of issuing notes is restricted to banks of large capital—if the note-holder has first lien upon all the assets of the bank, and if proper provision is made to secure the immediate redemption of notes, the note-holder

will be effectually protected even though the issues are based exclusively on assets of the bank.

I have suggested that the country be divided into banking districts, and that banks with a capital and surplus of not less than \$500,000 be allowed to issue notes; each district having its own safety fund, and the banks in one district not being responsible in any way for the note liabilities of failed banks in other districts. This district plan is recommended by two considerations: *First*. The strong banks of wealthy localities cannot object that the plan exposes them to distant risks over which they can exercise no supervision. *Secondly*. Each bank will be able to watch and, in some measure, moderate the operations of all the banks for whose note liabilities it is responsible to the extent of its deposit in the safety fund. For instance, if New England constituted a single district, common bonds of self-interest would unite all the note-issuing institutions of that region. The system of governmental supervision and examination would be reinforced in every possible way by the expert assistance of interested banks. As the notes would not bear the government guaranty, and would not be legal tender for any payment, the conservative banks would be able to check dangerous operations on the part of any bank merely by threatening to refuse acceptance of its notes on deposit.

If for any reason the division of the country into banking districts does not seem feasible, the note-issuing privilege should be restricted to banks whose capital and surplus amount to at least \$2,000,000. Notes would then be issued only by the banks of the largest cities, and the problem of supervision and control would not be difficult. Such notes should be redeemable over the counter of the issuing bank, and in one Central Reserve City.

To secure immediate redemption it is necessary to treat the bank note as a credit-instrument of the bank. It should, therefore, not bear the government guaranty, and should not be legal tender. The provision that a bank

shall be allowed to pay out only its own notes may prove unnecessary, yet it is a wise provision, for it makes prominent the fact that the bank note, like the check, is only a credit-instrument and must be redeemed. Under normal circumstances no bank will be willing to put the notes of other banks back into circulation ; self-interest will impel it to increase its own circulation instead.

The objection that the restriction of the privilege to banks of large capital will leave rural communities without aid in times of financial stress, is met by the provision for branch banks. These should be merely agencies of the parent institution, and should not be obliged to redeem notes. The liabilities of a branch bank would be liabilities of the parent bank, and would be protected by its cash reserve, so that the law need require no fixed reserve in the branches.

Evidently under this plan the note-issuing banks, with their power to establish branches, will have some advantage in the country districts over small and independent country banks. The branch bank feature of the plan may naturally, therefore, be antagonized by the small banks already existing. Their interests, however, are in some measure protected by the provision permitting the small banks to make free use of bank notes in their business. They will be restricted in the employment of these credit-instruments only by the preferences of customers, and by their own need of legal-tender money for the maintenance of the required cash reserve. Thus the small country banks will have access to a flexible credit-currency in times of stringency, and the large note-issuing banks will not be under strong temptation to establish branches in communities already supplied with banks of deposit and discount.

5. The note-issuing banks should be required to hold a cash reserve equal to 15 per cent. of their note liabilities in addition to such reserve as is required by law on account of deposit liabilities.

The fact should be noted that under a banking system

permitting the free employment of a bank's credit in the form of notes, the business of banking can be safely managed on smaller cash reserves than under a system lacking elasticity of note issues. Under our present system the minimum requirement of a 25 per cent. reserve in Central Reserve cities is too low. The banks of New York City, which hold a large part of the country's banking reserves, doing for the United States practically what the Bank of England does for the United Kingdom, ought, under the present system, to hold a cash reserve of at least 40 per cent., but should be allowed to employ that reserve freely, with the consent of the Secretary of the Treasury, whenever that seems necessary to avert panic. If, however, the element of elasticity is introduced into our bank note system, the present reserve requirement (25 per cent. of deposits) will be adequate for the New York City banks, provided that a proper reserve against note liabilities is also held.

6 to 8. Suggestions on the points raised in these questions are involved in answers to preceding questions.

9. Bank notes should be furnished to banks by the government, and should be uniform in style and color. They should not closely resemble any form of legal tender money.

10. To secure the elasticity of note issues it is essential that bank notes be not legal tender and be not endorsed by the National government. It is advisable also that no note-issuing bank be permitted to pay out the notes of another bank. A bank should treat the notes of other banks exactly as it does checks and drafts upon other banks.

11. In times of panic the banks will be able to provide all the currency needed if a plan permitting the issue of notes based on assets is adopted. They might be given authority to issue notes beyond the amount of their capital and surplus on payment of a tax of 3 per cent. or 4 per cent. upon such emergency circulation. Such a provision could do no harm, but it would probably be an unnecessary feature of the system.

12. Bank reserves should consist of legal tender money.

There should be no discrimination against any form of money bearing the government stamp.

13. National banks acting as reserve agents should not be forbidden to pay interest on the deposits of other banks. This is a matter which should be left with the judgment of individual bankers.

14. If the present banking system is continued, an elastic note issue not being provided, there should be a strengthening of reserves in one of two ways: Either the minimum reserve of Central Reserve City banks should be raised to 40 per cent., or the Reserve City banks should be required to hold all their reserves (25 per cent. of deposits) in their own vaults. If the present law is amended in either way, it will be safe to count the deposits of country banks in reserve cities as part of their required reserve to the extent of one-half of that reserve.

15. The minimum limit of capital should remain at \$50,000. The proposed reduction of the limit to \$25,000 would doubtless result in the establishment of many small banks and add greatly to the difficulties of National supervision. Besides, it is doubtful if much benefit would accrue to the small towns and communities which are now suffering most from the lack of opportunity to utilize their credit. What they need most is the assistance of outside capital, and that can best be furnished by the branches of large banks.

16. The existing tax upon State bank notes should not be repealed.

17 to 19. The points raised here have already been considered.

It should be noted that a bank note issue of the kind I have described cannot possibly lead to inflation of the currency. No banking plan should be considered for a moment which opens the door to a possible expansion of the currency beyond the demands of business, for such expansion will most certainly result in an exportation of gold liable to embarrass the United States Treasury and to destroy

confidence. But a bank note that rests mainly on assets, if it is not legal tender and is not guaranteed by the government, cannot possibly drive gold from the country. Such bank notes would be forced out of circulation by the very conditions which now lead to an exportation of gold, and thus the occasion for its export, viz. : the redundancy of the currency, would be automatically corrected. That an elastic banking circulation will act in this manner can be abundantly illustrated from the banking experience of Canada, France and Germany.

Elasticity is the most important need of our currency. It would be important even if all our government credit-money were retired, for it would render unnecessary large seasonal movements of gold to and from the country, as also the constant ebb and flow of currency between New York and other parts of the country. The export of gold is always the result of a plethora of money in this country as compared with other countries upon the gold standard. At such a time there is usually a glut of money in New York City and low interest rates prevail. An elastic banking circulation will correct the tendency to periodical congestion in the New York money market, for there will be an immediate contraction of the volume of bank notes throughout the country whenever business relaxes and the demand for money decreases.

#### DEFECTS OF THE BANK NOTES NOW ISSUED.

A brief consideration of the inherent defects of the national bank note, as now issued, will make clear the reasons why bank note issues based upon bonds of any kind, must be condemned. Such bank notes are of necessity an objectionable constituent of the circulation. Under certain circumstances they are a serious menace to the gold standard.

The national bank note system is defective in two important respects: First, its note issues are not made in response to a demand for a medium of exchange, but in response to a demand for investments; second, since these

note issues are guaranteed by the government and are legal tender between banks and in payment of dues to the government, they are in no sense based upon the credit of the issuing banks and do not retire from circulation as the needs of business diminish.

With respect to the first defect of the system, it is evident that the willingness of banks to increase their circulation at a given time, depends upon the price which they must pay for government bonds and upon the market rate of interest. If the price of government bonds is low and the market rate of interest high, a large profit is offered to a bank upon its circulation and it is under temptation to issue bank notes up to the limit permitted by law.

On the other hand, high prices of bonds reduce the profit on notes and lead banks to curtail their note issues. Consequently, it happens that in times when an increase of the currency is needed, the business of the country being active and expansive, government bonds selling at a high price even though interest rates are rising, the National banks are under no temptation to increase their circulation and the country is obliged to import gold from Europe to serve as a basis for its expanding credits. On the other hand, in times of depression, when the volume of money needed by the country's business is diminishing, and interest rates fall to a minimum, then the banks, unable to employ all their capital profitably in business, see a chance to make a small profit through the purchase of government bonds and the issue of bank notes; thus they inflate the currency at the very time when contraction is dictated by the conditions of trade.

The fact that the National bank note does not perform any of the services of a genuine bank note, has been clearly illustrated by the experience of the last half dozen years. From 1882 until 1889 there was a pretty steady advance in the price of government bonds; the 4's of 1907 having risen from 103 in 1880 to 129 in 1889. In 1880 and 1881, while these bonds were selling between 103 and 112, there

was some increase in the National bank circulation; but their price touched 120 in 1882, and for nine years thereafter, the bonds being high priced, there was a steady decrease in the note circulation of the National banks. The financial panic of 1890 caused a fall in the prices of government bonds, and thereby increased the chances of profit on the circulation of National bank notes. As a result there was a net increase in their circulation of \$13,000,000 in 1891, and of \$8,000,000 in 1892. Now, in these two years, there was absolutely no call for an increase in the circulating medium of this country; on the contrary, the Treasury Department in these years was injecting arbitrarily between \$25,000,000 and \$50,000,000 of silver paper money into the currency of the country, as a result of the Silver Purchase Act of 1890, and gold, in consequence, was being exported at a rate which alarmed business men and finally precipitated the panic of 1893.

During 1893 the 4's of 1907 sold down to 108, and the banks added to their circulation \$37,000,000. During the months of June, July and August of that year there was a most urgent need for an expansion of the currency; but during these months the new National bank notes did not appear. Not till after the panic was over, and money was piling up in all the financial centres—a drug on the market—did the increase in the National bank note circulation take place. As a result of the panic, business being depressed, the interest rate on prime commercial paper during 1894, 1895 and 1896 was between 3 per cent. and 4 per cent. The money supply of the country was in excess of its needs, and gold was exported in large amounts. The Treasury, embarrassed by the withdrawals of gold, was forced to issue bonds in order to maintain the gold reserve. These bond issues forced down the prices of bonds, and thus increased the profit which banks could make upon new circulation. Therefore considerable idle banking capital, which could be loaned barely at 3 per cent. in business, was exchanged for government bonds and made the basis

for bank notes, so that in 1895 and 1896 there was a net addition to the bank note circulation of \$32,000,000. Thus, the National bank note helped to embarrass the government by inflating the currency at a time when the government was doing its utmost to prevent inflation and prevent the exportation of gold to Europe.

It is not quite right, therefore, to say that the National bank note is an inelastic element of our currency. It is elastic; it does contract and it does expand. But, unfortunately, it is likely to contract when we need more money, and to expand when we want less money. It performs none of the services for the community which a genuine bank note, based on the credit of the bank, and properly safeguarded, can be made to perform.

The history of our National bank note system certainly seems to furnish conclusive evidence that a bank note based upon bonds is without justification. The nature of the bonds is not important. The same objections hold whether the bonds are National, state, municipal, or railroad corporation issues.

It follows, therefore, that the National bank notes, of the kind now in circulation, being dangerous as well as useless, ought to be retired. Steps should be taken toward this end even though no agreement can be reached regarding the kind of bank note that shall be substituted. They now fill a place in the circulation which should be taken by gold, and if provision is made for their gradual retirement, it will not be a difficult matter to effect the substitution of gold without any harmful contraction of the currency. The country does not need these bank notes; it does need gold.

In conclusion I desire to say, that before answering the questions of the Commission I discussed the points raised with my colleagues, Professors Falkner, Seager and Lindsay. At my request they have read my discussion of the interrogatories, and have promised letters containing sup-

plementary suggestions. These letters I shall take pleasure in appending hereto.

OCT. 21, 1897. JOSEPH FRENCH JOHNSON,  
University of Pennsylvania.

UNIVERSITY OF PENNSYLVANIA,  
PHILADELPHIA, Oct. 29, 1897.

PROFESSOR JOSEPH FRENCH JOHNSON,  
University of Pennsylvania,  
Philadelphia.

MY DEAR PROFESSOR JOHNSON :—

It has given me much pleasure to read the replies which you have framed to the questions asked by the Monetary Commission. At your request I shall give you my impressions of them.

With the main features of your replies I most heartily concur. A careful reading will show a clear and consistent view of the monetary situation. In endeavoring to answer the questions proposed by the Monetary Commission *seriatim*, there is danger of an appearance of inconsistency, since the questions have necessarily been framed with a view to several possible modes of action. In discussing one policy, showing its advantages and disadvantages, it is not always possible to indicate, that the policy under discussion is on the whole of doubtful expediency and inferior to other policies to be discussed elsewhere.

The problem presented in this series of questions is the maintenance of the present metallic currency standard, and its relation to the credit-money of all sorts now in circulation. What adjustments in our whole currency system are necessary to best adapt it to the economic necessities of our people?

The demand for money is not a fixed and unchangeable quantity. If it were, there would be no money question. On the contrary, the demand for money grows steadily with the increase of population and growing intensity of trade.

Again it fluctuates from season to season, according to emergencies of National life. An ideal money circulation is both expansible and elastic. The two terms are not used synonymously: the first is intended to describe the gradual adaptation of the monetary circulation to the needs of trade; the second to indicate the facility with which temporary and sudden demands can be met.

In any monetary system, it is the primary function of metallic money to supply the element of steadiness and expansibility, while it is the primary function of credit-money to supply the element of elasticity.

In an ideal system of money these two forms cannot interchange functions. Any proposal, therefore, which contemplates such a reorganization of bank notes as to rely upon them to meet the permanent needs of increased currency is based upon a misapprehension of the function of such notes. Any plan which so facilitates the issue of bank notes as to encourage their issue in large quantities is fraught with danger.

Government credit-money is an anomaly in an ideal money system. But few nations possess an ideal system. In the United States, our silver issues (dollars, certificates and Sherman notes), United States notes and National bank notes, partake of the nature of government credit-money. The aggregate amount of such credit-money in proportion to gold, which constitutes our standard, is so great as to constitute a continual menace to the integrity of our metallic standard. The remedy is obviously to increase the base or diminish the amount of credit-money. Through the free coinage of gold there is some probability that if things remain as they now are the gold stock of the country will increase. Through a reorganization of the National banks, with note issues not guaranteed by the government, the present amount of such notes could be maintained in circulation, and the ratio between the gold stock and government credit-money reduced.

There remain the silver issues and the United States

notes. Experience has shown that a certain amount of government credit-money may be maintained without endangering the metallic basis of the currency. Practical difficulties oppose the retirement of these issues and notes by any except the most gradual means. It can only be done in case means be devised whereby the retirement of these issues and notes could be effected without diminishing the total amount of government money, by substituting metallic money for credit-money. In the present temper of the country it is highly improbable that gold can be obtained by an issue of bonds.

In the present situation the practical problem narrows down to a reform of the banking system. A banking scheme which permitted the issue of notes upon assets, would accomplish two things: 1st, it would relieve the strain upon the gold supply; 2nd, it would furnish an element of elasticity in our currency which would better fit us to meet the emergencies and crises of economic life. The plan which you propose for the organization of the banking system would, I believe, secure these ends.

The advantages to be gained by a re-organization of bank note issues do not constitute a solution of all our monetary difficulties. They are none the less of great value. They are a step in the right direction and should not be disdained, since human progress can only be attained by patient effort and gradual advance. But in commending such a policy, it may be well to recognize its limitations, to note that the scope of the reform is not so wide as some would have us believe, and avoid extravagant claims, which may be a bar to the attainment of the ends which we have in view.

Very truly yours,

ROLAND P. FALKNER.

UNIVERSITY OF PENNSYLVANIA,

PHILADELPHIA, Nov. 1, 1897.

PROFESSOR JOSEPH FRENCH JOHNSON,

University of Pennsylvania,

DEAR PROFESSOR JOHNSON :

It gives me great pleasure to comply with your request for a brief statement explaining my views on the questions submitted by the Monetary Commission, although my opinions are in such substantial harmony with those which you have expressed that I fear I shall add little or nothing to your own report.

Like many others, I am firmly persuaded that too much of the money now in circulation in this country is government credit-money and too little of it gold, for perfect security. I believe that at least half of the government credit-money now in circulation in the form of greenbacks, Sherman notes, silver certificates, and silver coin, should be called in and cancelled. This may be done either by an issue of bonds or by a judicious use of a surplus revenue to be created by additional taxation.

The paper money being, on the whole, cheaper and more convenient than silver should, aside from political considerations, be allowed to remain in circulation until all of the silver, except the fifty or sixty millions really required by the business community for use as change, has been withdrawn. Still overlooking political considerations—as the professed theorist is permitted to do—the Treasury should sell as bullion all of the silver which it now holds in its vaults and which is withdrawn from circulation, on as advantageous terms as the market conditions permit. The present, I believe, is a favorable time for the Treasury to unload the silver that has been piling up in its vaults as a guarantee to citizens who accept its credit-money. This silver is not adequate as a guarantee, and it is, moreover a very expensive kind of reserve for the government. Gold would be in all respects preferable. If all our silver dollars but about sixty millions were retired, I believe that the greenbacks might safely be left in circulation.

The place of the money so withdrawn would be taken to a large extent by gold, of which we now have too small a quantity in proportion to our total money supply. To a small extent, the government credit-money retired might be replaced by bank credit-money if only our bank note system were reformed at the same time that the volume of government credit-money was being reduced.

In the reform of our bank note currency, it seems to me that the following principles, emphasized at length in your replies, should be recognized as fundamental: (1) Bank notes should rest on the credit of the bank and on this alone; (2) Such notes should no more be a legal tender than are certified checks or any other form of money surrogate based on the credit of individuals; (3) They should be redeemable at all times by the issuing bank on demand in gold or its equivalent.

Legislation embodying these three principles and providing adequate safeguards against reckless banking, in the way of reserves, periodical bank inspections and double or treble liability of stockholders, would furnish the country with an abundant and elastic paper currency for its local trade and at once withdraw the United States from that group of unfortunate nations whose business classes are required to concern themselves continually in regard to "gold movements." I believe that our present bank note currency, based, as it is, on the credit of the government, has no merits that simple government credit-money does not possess. Instead of being the safety-valve of our money mechanism, as a bank note currency ought to be, it has the tendency, which you have described, to aggravate the evils resulting from the excessive issue by the government of its own credit-money. Its volume expands when it ought to contract and contracts when it ought to expand.

A bank-note currency, conforming to the three principles enumerated above, would have two qualities which no system of government credit-money yet devised has been found to possess: it would be very sensitive to the changing needs of the business community for a circulating medium,

and it would be sufficiently elastic to adapt its volume promptly and accurately to those needs. It would thus serve to satisfy the requirements of each locality for an elastic medium of exchange, and make the country as a whole dependent on an increased supply of the basic money material—gold—only as its population and the volume of its exchanges increase. Whether the annual production of the yellow metal, together with the increasing use of credit substitutes for money, might be relied upon to keep pace with this expanding need on the part of the United States and other countries of the world, is a question not raised by the Monetary Commission, and, therefore, not pertinent to their inquiry.

This is a very general statement of views differing only in details from those to which you have given expression. If they can add anything to the force of what you have said concerning the necessity of reform in our bank-note system, I shall feel amply rewarded for having formulated them.

Very truly yours,

HENRY R. SEAGER.

UNIVERSITY OF PENNSYLVANIA,  
PHILADELPHIA, Nov. 1, 1897.

DEAR PROFESSOR JOHNSON :—

In addition to the discussion which we have had together over the Interrogatories of the Monetary Commission, I have read carefully your excellent report on the subject. I do not think that there is anything in it to which I am not willing to subscribe. There are parts of it which I would like to see more strongly emphasized, and there are two additional recommendations which I submit herewith.

In following the questions *ad seriatim*, which I suppose is the form in which the Monetary Commission desires you to reply, you are unfortunately compelled to present your ideas out of all perspective as to their relative importance in a scheme of currency reform, and often with an appearance of inconsistency when dealing with questions bearing

on radically different hypothetical conditions. The gist of your reply, as I take it, is that at present the greatest need is for a change in our banking laws, and, secondly, measures looking to the increase of the gold supply in the hands of the United States Treasury. It is to these two points that I think the Commission can most profitably turn its attention with the hope of securing solid support in the country at large for any reasonable recommendations. All questions bearing on the existing forms of currency, with the exception of the National bank notes, seem to me to be secondary questions, which might be considered best in the light of adjustments of the existing currency to any new system which may be proposed. It is here, of course, where political, sectional, and individual business interests are most apt to conflict. These really minor questions are likely to be made the chief topic of debate in Congress, and to be used as excuses for dodging the real questions at issue. Would it not, therefore, be well in any practical measure that may be laid before Congress, to have it as simple as possible, and directed wholly to taking the United States Treasury out of the banking business, by providing a satisfactory basis for a bank-note circulation, and, secondly, to maintaining a sufficient supply of gold in the Treasury?

If it is impossible to withdraw the greenbacks, it seems to me that their evil effects, in compelling the United States Treasury to act as chief bullion broker for the country, might be counteracted in the way which you suggest, by re-issuing greenbacks, when presented for redemption, only in small denominations; or, and this is my first additional recommendation:

Redeem notes only in United States gold coin and not in bars, which is the favorite form for export. Secondly, redeem no notes, except when presented through National banks, and, perhaps, charge a small percentage for cost of redemption when presented in sums of over \$1000 by one bank, during the hours of any one business day. Such regulations would in no wise impair the integrity of specie

payments, but would operate as checks on sudden withdrawals for export, and drive those desiring gold as a commodity to the bullion brokers. This would not, of course, be in itself a sufficient remedy for maintaining in the Treasury an adequate supply of gold. It is merely a suggestion for preventing the greenback being used as it has been in the past to embarrass the Treasury. A better method would be to do away with the greenback altogether, and then I do not think that the Treasury needs any additional legislation to maintain its gold supply, except such as looks to making the government's revenue always slightly exceed its expenditures.

My second additional recommendation concerns also the question of the ultimate retirement of the greenbacks. We must, I think, anticipate a time in the near future when the government's finances will improve, and perhaps a return of the good old times when the question was what to do with the surplus. Would it not be well now to embody in any plan which has not the courage to insist on the retirement of the greenbacks at least a recommendation looking to their future retirement? The Secretary of the Treasury might be required to use all gold in the Treasury exceeding say \$150,000,000, for the redemption and retirement of greenbacks. That is, whenever the gold reserve reaches the \$150,000,000 mark, all excess shall be reserved or held as a fund for the redemption of greenbacks until in this way an amount is accumulated sufficient to cover all outstanding greenbacks. Such a proposition might not encounter as strong opposition as one looking to the immediate retirement of the greenbacks, and might accomplish a good work in the future.

These suggestions are of minor importance in comparison with your full and painstaking report, with which I feel myself in hearty sympathy.

Yours sincerely,

SAMUEL McCUNE LINDSAY.

TO PROF. JOSEPH FRENCH JOHNSON,  
University of Pennsylvania.

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